

Amendments to the Financial Investment Services and Capital Markets Act - Private Equity Funds

As noted in our previous legal update, various amendments to the Financial Investment Services and Capital Markets Act (the “Capital Markets Act”) were recently promulgated on May 28, 2013. This legal update is the second of a series of updates that will summarize the amendments made to the Capital Markets Act and discuss the major issues relating to such amendments.

The following is a summary of the amendments made to the private equity fund provisions of the Capital Markets Act.

1. Establishment of a Registration System for Managers of Private Equity Funds (Article 272-2 of the Amended Act, Article 12 of the Addenda)

The amended Capital Markets Act (the “Amended Act”) requires that an entity intending to manage a private equity fund as its general partner register with the Financial Services Commission (the “FSC”), which requires satisfaction of certain registration requirements (the “Registration Requirements”).

¹Accordingly, a general partner intending to establish a private equity fund under the Amended Act is required to register itself with the FSC, apart from the establishment and registration of the private equity fund (effective as of August 29, 2013).

The above amendment has been introduced to reflect the current global discussions on regulation of private equity funds. While the Capital Markets Act in effect prior to the amendments (the “Existing Act”) has no particular requirements for general partners of private equity funds (license or other qualification requirements), the Amended Act allows only those who meet the Registration

¹ **Registration Requirements:** (1) equity capital in excess of the amount prescribed in the Presidential Decree; (2) no executive officer being subject to any disqualification; (3) at least a certain number of fund managers as prescribed in the Presidential Decree; and (4) proper compliance policies being in place.

Requirements to establish and manage private equity funds.

The Amended Act also includes transitional provisions for general partners of existing private equity funds. General partners of private equity funds already registered with the FSC at the time of coming into force of the Amended Act will be deemed to have been registered with the FSC, but only with respect to the management of such already registered private equity funds. It should thus be noted that an existing general partner will be required to register with the FSC pursuant to the Amended Act if it plans to establish and manage a new private equity fund after August 29, 2013.

2. Specification of Investment Requirements with respect to Mezzanine Securities (Article 270(1), (4) and (6) of the Amended Act)

Under the Existing Act, a private equity fund is permitted to invest in bonds with warrants or convertible bonds (“Mezzanine Securities”) for the purpose of (i) acquiring 10% or more of the total number of outstanding voting shares of a company or (ii) exercising de facto control (“Management Control Purpose”) over the major business affairs of a company (such as the appointment and dismissal of its officers). The Amended Act, however, requires that the details of such investment requirements be prescribed in the Presidential Decree (effective as from May 28, 2013).

This amendment has been introduced to address some ambiguity in the interpretation of the Existing Act with respect to the requirements for investment in Mezzanine Securities, including the requirements for acquisition of Mezzanine Securities, and the timing of exercise of the rights under, and disposition of, Mezzanine Securities. Accordingly, the Amended Act is intended to foster investment in Mezzanine Securities by providing more detailed provisions regarding what is required for an investment in Mezzanine Securities for a Management Control Purpose. However, since the details of such investment requirements have been delegated to the Presidential Decree, it will be necessary to see what the Presidential Decree will state.

In addition, private equity funds are now required to hold Mezzanine Securities for at least six months (effective as of August 29, 2013). Accordingly, private equity funds intending to dispose of their Mezzanine Securities should note this amendment.

3. Obligation to Report Borrowings or Guarantees of Debt by Private Equity Funds (including Special Purpose Companies) (Article 270(9) of the Amended Act)

Under the Amended Act, private equity funds and special purpose companies will now be obligated to report to the FSC the current status of any borrowings and guarantees of debt (effective as of August 29, 2013).

Currently, borrowings or guarantees of debt by private equity funds and special purpose companies are significantly restricted under the Capital Market Act (i.e., no more than 10% of the value of the assets of a private equity fund, and no more than 300% of the value of the assets of a special purpose company). The Amended Act imposes a reporting obligation on top of the restriction on borrowings and guarantees of debt, in order to tighten the supervision of private equity funds.

Should you have any questions regarding any of the foregoing, please feel free to contact us at any time.

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